

HST or PST?
The Real Truth or Consequences

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**“An error does not become truth by reason of multiplied propagation,
nor does truth become error because nobody sees it.”**

Mahatma Ghandi

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The “Fight HST” group recently released a report entitled “HST or PST? The Truth about the HST and Why Returning to the PST Is Better for BC ...”¹ The word “Truth” in its title is ironic, since the report is densely laden with factual errors, idle speculation, economic illiteracy, and faulty and often tortured logic. While the “Truth” report seeks an aura of impartiality and reputability by citing many web-based sources, it is in fact a jumble of confused and conflicting assertions. The “Truth” report aptly illustrates the wisdom of the adage, “A little bit of knowledge is a dangerous thing.” In this response to the “Truth” report, I seek to clarify the real facts, evidence, logic, and economic basis for BC’s shift from the provincial sales tax (PST) to the Harmonized Sales Tax.² My discussion exposes the substantial adverse consequences that British Columbians will face if they make an ill-informed decision to restore the PST.

Before addressing each of the report’s “top ten reasons why the HST is not good for BC,” several key points are useful in understanding the comparison between the HST and BC’s former sales tax. First, over 140 countries around the world—including advanced, transitional, and developing economies—have taxes of the same type as the Harmonized Sales Tax and the federal GST. These taxes are more generically called “value-added taxes” or VATs. Sales taxes having the format of BC’s former PST are found only in three other Canadian provinces (Saskatchewan, Manitoba, and Prince Edward Island) accounting for less than 7 percent of the Canadian economy plus most US states. Most countries that now have VATs once used more primitive and economically distorting sales taxes like the PST and even worse turnover taxes. They turned to the VAT format because of its proven advantages for economic growth, investment, job creation, and workers’ earnings.

¹ <http://fighthst.com/media/TheTruthAbouttheHST.pdf>

² While I do not reference most of my sources here, these can be accessed in the bibliographies of my two previous studies on this topic. See “The Harmonized Sales Tax—Through an Economic Prism,” *Policy Perspectives*, Vol. 17, No. 2 (April 2010), <http://www.bcbc.com/Documents/ppv17n2.pdf>; and “Consumer Impacts of BC’s Harmonized Sales Tax,” report at Business Council of British Columbia (February 2011), http://www.bcbc.com/Documents/EC_20110216_Kesselman_ConsumerImpactsofBCHST.pdf.

Second, the VAT format and thus the HST is the sales tax format preferred by every knowledgeable expert in the fields of tax economics, tax law policy, and tax accounting policy. Support by experts for the sales tax harmonization moves by both British Columbia and Ontario is truly unprecedented in the area of major tax reforms; almost every other major tax change has had its legions of knowledgeable critics as well as supporters. Moreover, no taxation expert and no responsible government would contemplate shifting back from a VAT to a sales tax of the PST form. Such a retrograde change has no precedent anywhere in the world. Thoughtful citizens who are not experts on tax policy or not well tutored in tax economics might wish to give heed to consensus thought among those who have studied the issue long and hard. The “Truth” report was not able to cite even a single authoritative tax policy expert who overall preferred BC’s or Ontario’s old PST to the HST. If you had a serious physical ailment, would you follow the unanimous advice of the medical profession or seek out a faith healer?

Several key facts and findings are essential preliminaries to assessing the “Truth” report’s ten assertions.

- British Columbia’s former PST collected about \$5 billion in annual revenues, of which 48 percent was imposed on businesses rather than directly on consumers. If the full PST burden on businesses had been removed and instead collected from consumers using the PST with its original limited base (which excluded a few goods and many services), the rate would have to be doubled to 14 percent to collect the same revenues. The PST thus contained a massive element of hidden taxation—burdens that BC consumers were bearing (through higher prices on their purchases) without realizing it.

- The impact of the HST on BC consumers will be less than the amount that we pay in additional provincial tax of 7 percent on newly covered goods and services, because of i) the potential pass-through of business tax savings under the HST in the form of lower prices to consumers; and ii) the partially offsetting annual sum of \$410 million in compensation to BC residents via the HST credits that benefit lower income households and personal income tax cuts that benefit all taxpayers.

- The true measure of the impact of the BC HST is the increase in the cost of living for British Columbians caused by the shift to the HST and excluding the rate of inflation that would have occurred in BC without the tax change. This impact will be less

than the additional HST that we pay relative to what we paid under the PST to the extent that businesses pass through their tax savings to BC consumers.

- If the switch to HST had been accompanied by zero pass-through of business tax savings to consumers, the impact on the BC consumer price index (CPI) is calculated to be about 1.3 percent.³ If businesses passed through to BC consumers all of their tax savings associated with their in-province sales of goods and services, the impact on BC's CPI is calculated to be about 0.6 percent. These are all straightforward calculations based on the dollar amounts involved in former PST total burden on business that was removed by the HST, the amount of PST burden on business associated with their in-province sales but removed by the switch to HST, and consumer expenditures in the province.

- Examining actual data from Statistics Canada for BC's CPI from before the tax regime change (June 2010) to the post-HST period—and adjusting for ongoing inflation based on experience of the other Western provinces that do not have an HST—yields an estimated impact on BC's CPI of 0.5 to 0.6 percent.⁴ These figures are consistent with full pass-through of business tax savings from HST on their in-province sales. They imply that the typical consumer is bearing just one extra dollar in costs for every \$165 to \$200 spent on the full basket of goods and services. These figures do not even consider the offsetting savings through households' receipt of HST credits and income tax cuts.

- The small additional burden on BC households as consumers and taxpayers is explained mainly by the net savings to BC businesses that produce primarily for sale outside the province (exports both abroad and to other provinces). Those savings provide the stimulus for additional investment in BC, yielding more and better paying jobs over the long run, and ultimately a more prosperous province with additional tax revenues through income, sales, and property taxes to support BC public services. In addition, when BC businesses that produce mainly for in-province sales pass through their savings

³ The HST added 17 percent of consumer spending to BC-taxable status, which at a 7 percent additional tax with no pass-through would raise the CPI by 1.19 percent ($7 \times 0.17 = 1.19$), and a small additional impact on the CPI arises through taxes borne by HST "tax-exempt" items.

⁴ My initial analysis and the finding of a 0.6 percent CPI impact for BC covered the period June 2010 through December 2010 and was reported in "Consumer Impacts of BC's Harmonized Sales Tax"; my revised and updated study extending the observation period through February 2011 and finding a 0.5 percent CPI impact will be published in the June 2011 issue of *Canadian Public Policy*; my paper was reviewed by three independent expert referees.

to consumers, this allows them to be more competitive with out-of-province suppliers and thereby also yields additional investment, jobs, and worker earnings.

I now turn to the ten charges that the Fight HST's "Truth" report levels at British Columbia's HST, using the reverse-order numbering adopted in that report.

10. HST hurts families, seniors and low income people most

"The HST is a regressive tax that forces middle and lower income people to pay a greater proportion of their income to acquire the same goods and services as those with higher incomes. The HST hurts poor people the most."

Like any sales tax including the PST, the HST is by nature "regressive"; that is, it takes a higher portion of income from lower income households than from higher income households. The reasons are two-fold: i) lower income households save relatively little, so that most or all of their income is spent and therefore incurs sales tax, whereas higher income households save more of their income and thus less of their income is spent and exposed to sales tax; and ii) the progressive personal income tax takes an increasing share of higher incomes, meaning that higher income households have less of their income left after paying income tax to either spend or save and thus less to incur sales tax. The key question here is not whether the BC portion of the HST is regressive, but rather whether it is *more regressive* or *less regressive* than the PST that it replaced.

The "Truth" report cites a study by economist David Murrell, quoting him as concluding "The HST is a pure tax increase and is regressive." That quotation has been massaged by the "Truth" authors, as Murrell's actual wording was "the pure HST tax increase is regressive" and goes on to state "But the accompanying personal-income tax cuts are very progressive, such that on balance the net impact is modestly progressive—from the poorest to upper-middle class families."⁵ By "the pure HST tax increase," Murrell meant the change from PST to HST alone, without considering the companion credit and income tax reliefs. However, even without considering those compensatory provisions, there are problems with his finding that the HST was more regressive than the

⁵ David Murrell, "Impact of HST on Ontario and British Columbia Households by Income Quintiles" (Ottawa: Canadian Centre for Policy Studies, Aug. 2010), p. 3, www.policystudies.ca. Note that the paper "takes no position as to the merits or demerits of the harmonized HST tax. There is a considerable body of literature by economists favouring the tax" (p. 4).

PST it replaced. Murrell's analysis *assumed* that pass-through of business tax savings would be just 20 percent in the HST's first year and still only 60 percent in year 3 (p. 10); in contrast, my analysis *computed* pass-through that was much higher and faster (within five to seven months). Moreover, the goods and services bearing the most rate increases with BC's HST are more heavily consumed by higher-income households, while those items most insulated from tax increases or even experiencing price declines are a larger part of the budgets of lower-income households.⁶

With an overall impact on the cost of living for British Columbians of just 0.6 percent,⁷ the extra HST burden is more than offset for most poor and moderate income households by the HST credits and income tax cut. Even at upper-middle incomes the incremental net burden is very modest. A few examples support this conclusion:

- Single adult earns \$15,000; after deducting social insurance contributions, spends \$14,200; HST extra burden is $0.6\% \times \$14,200 = \85 ; net out \$230 HST credit (no benefit from the BC income tax cut) for *net gain of \$145*.
- Single adult earns \$20,000; after deducting income taxes and social insurance contributions, spends \$18,000; HST extra burden is $0.6\% \times \$18,000 = \108 ; net out \$230 HST credit and \$80 income tax cut for *net gain of \$202*
- Single parent with two children with total income of \$30,000; spends \$26,000 after deductions; HST extra burden is $0.6\% \times \$26,000 = \156 ; net out \$490 HST credit ($\$690 - 0.04 \times \$5,000$) and $\$80 \times 2$ income tax cut for *net gain of \$294*
- Single adult earns \$50,000; spends \$40,000 after deductions and savings; HST extra burden is $0.6\% \times \$40,000 = \240 ; net out \$80 income tax cut for *net burden of \$160—just about \$3 per week*
- Two-earner couple, total earnings of \$100,000; spends \$75,000 after deductions and savings; HST extra burden $0.6\% \times \$75,000 = \450 ; net out $\$80 \times 2$ income tax cuts for *net burden of \$290—less than \$6 per week*

Thus, poor households and those at moderate incomes are actually net gainers from the switch to HST.⁸ Low-income seniors benefit further—in fact being doubly compensated—because their Old Age Security and Guaranteed Income Supplement benefits are also indexed for the price increases caused by the implementation of HSTs in BC and Ontario.

⁶ These findings are based on analysis using a Statistics Canada study and reported in a table in my paper “Consumer Impacts of BC’s Harmonized Sales Tax.”

⁷ I use the higher of my two estimates to put the illustrative figures on the cautious side.

⁸ A study of the Ontario HST undertaken for a left-leaning think tank found, similarly, “Poor families ... come out ahead by around \$200 ...” Ernie Lightman and Andrew Mitchell, “Not a Tax Grab After All: A Second Look at Ontario’s HST” (Ottawa: Canadian Centre for Policy Alternatives, December 2009), p. 4, www.policyalternatives.ca.

9. HST is inflationary

“To avoid a decrease in the standard of living, HST paid by consumers must be charged back to employers in the form of higher wages—ultimately wiping out any benefits to business. In Europe, the VAT started at about 6% in most countries and has grown to as high as 25% in places like Denmark, Hungary and Sweden.”

As shown by my cited estimates, the impact of BC switching from the PST to the HST was an increase in the provincial consumer price level of just about 0.5 to 0.6 percent. This was a one-time increase in the price level, not an ongoing rise and thus not a continuing hike in inflation. Moreover, this small increase is within the ordinary range of year-to-year variation in BC’s change in consumer prices even in the pre-HST period. Contrary to the assertion in the “Truth” report, there is no evidence that adoption of BC’s HST has led to workers getting higher wages to compensate for the decrease in standard of living caused by the HST. If workers had been getting such wage increases to offset their HST impact, no one—at least no working person—would be complaining.

The fact that many European countries, some of which began their VAT systems as far back as the 1950s, have increased their tax rates over time is neither surprising nor relevant to the HST in British Columbia. The culture and political economy of those countries diverge widely from those of Canada or BC; European payroll taxes have risen even more sharply over that period. British Columbia initiated its PST in 1948 at a rate of just 3 percent versus today’s 7 percent for the BC portion of the HST (and the last rate for PST). Governments will increase (or occasionally decrease) their tax rates based on their fiscal needs of the day and political calculus. Whether BC had retained its PST or with its current HST, changes in the tax rate in either direction are always a possibility. In fact, however, because the PST hides nearly half of its burden from consumers and most voters by imposing it on businesses, the PST is more likely to have its rate increased than the much more fully visible HST. Witness the fact that the similarly highly visible federal GST has experienced two rate *decreases* in the last few years.⁹

⁹ The “Truth” report states that “The HST always goes up” and then cites examples of VAT hikes in Europe; curiously, it later cites the example of France sharply reducing its VAT rate on restaurant meals. It also neglects to cite Canada’s GST rate cuts.

8. HST is economically counter-intuitive

“BC’s big resource companies get most of their money from selling goods overseas and to the United States—which is new money coming in from consumers outside BC. Exempting business from sales taxes means government is taking all of its sales tax revenues from consumers inside our economy and then transferring \$2 billion of it back to corporations mostly headquartered in Europe, Asia or the U.S. That doesn’t make economic sense.”

The unnamed “Truth” report authors along with many HST critics cannot see the “economic sense” in BC’s tax harmonization because they do not understand the underlying economics. By removing the PST formerly borne by businesses on their purchases of many inputs, the HST provides a more efficient allocation of resources in the BC economy. Previously, many items sold between firms bore tax at each level, and thus tax was imposed on a price that already included tax in a process known as “tax cascading.” By removing those taxes at all the stages of production other than the final sale to the consumer, the HST allows BC businesses to compete more effectively in its “export” sales (to customers in other Canadian provinces and abroad) as well as its sales to BC consumers versus non-BC suppliers. The reason is that goods and services exported from the province no longer bear the tax burden (charged only to BC consumers), and BC-produced goods and services sold to BC consumers no longer bear a tax penalty vis-à-vis competing non-BC suppliers.

The notion that under the old PST the BC government was actually collecting taxes from out-of-province customers of BC business is erroneous for most products. The majority of BC businesses’ out-of-province sales involve resources and other goods and services where the prices are set on national or world markets. Thus, any extra tax burden on the business simply adds to its costs and must be accommodated by some combination of lower employment and wage payments, lower investment in productive capacity, and lower profitability. The “Truth” report assumes that eliminating these tax costs for business under the HST will yield solely higher profits but no additional employment, wages, or investment. That assumption runs contrary to all economic evidence on how businesses respond to changes in their costs, particularly changes that affect the cost of tangible investment. Reducing the cost of investment goods increases

the level of business investment, although this response is typically spread over a period of years and not just months. Both in the process of producing or installing the new investment (and associated structures and related services) and in putting the new machinery and equipment to use, businesses hire more workers and increase payrolls. One estimate of the employment gains for BC stemming from the HST by the year 2020 is 113,000 additional jobs.¹⁰ Some of the biggest gainers will be in the resource sector in regions of the province suffering high unemployment and most in need of jobs. Given this sector's above-average wages, the prospective loss of worker remuneration from abandoning the HST could exceed \$5 billion annually by end of the decade.

7. HST curbs consumption, reduces tax revenues and increases the tax burden

“The HST in BC will take a total of \$2 billion per year out of our economy—or an average of \$400 more from every man, woman and child. Reduced consumption results in reduced government tax revenues. Governments must then either cut spending, increase debt, or raise taxes. Under the HST, they will end up doing all three.”¹¹

The \$2 billion figure asserted in the “Truth” report is far from the mark in terms of the actual additional transfer of burden to BC consumers and the removal of consumer purchasing power. First, the actual figure should be \$1.9 billion in reduced tax burden on business. With essentially full pass-through of the business tax savings on in-province sales, British Columbians are getting back through price relief about \$1 billion of this amount. Price relief can take the form of both actual price cuts and, more often, reduced inflation relative to what BC would have experienced without the shift to HST. Another \$300 million is attributable to the tax burden on “public sector bodies” (municipalities, universities, schools, colleges, hospitals). So the net incremental impact on consumers is \$600 million¹² plus the \$400 million that was needed to finance the HST credits and income tax cut; but since the HST credits and income tax cut go back into the pockets of households, the \$600 million figure is most appropriate as the net burden. That \$600

¹⁰ Jack M. Mintz, “British Columbia’s Harmonized Sales Tax: A Giant Leap in the Province’s Competitiveness,” *SPP Briefing Papers*, Vol. 3, No. 4 (The School of Public Policy, University of Calgary: March 2010), <http://www.policyschool.ucalgary.ca/files/publicpolicy/bctaxonline.pdf>

¹¹ I deal with the revenue and fiscal assertions in this statement in addressing the “Truth” report’s point 3 below.

¹² That is, \$1.9 billion – \$1 billion – \$0.3 billion = \$600 million. For details on these figures, see “Consumer Impacts of BC’s Harmonized Sales Tax.”

million or \$130 per capita is the annual net cost to British Columbians of achieving significant gains to future economic prosperity and growth of the province.

If BC consumers were to cut their spending by their full \$600 million net cost of the HST—and not cushion this by reducing their savings—this would still amount to well under one-half of one percent of total BC consumer expenditures. The actual statistics show BC retail sales essentially unchanged in the last six months of 2010 after the HST was implemented.¹³ Given the normal tendency for spending to rise over time, this likely reflects a small dampening effect from the HST over this period—but nothing like the apocalyptic warnings in the “Truth” report. Consumers may have curtailed spending in areas that were newly taxed, such as restaurant meals, but these dollars were mostly diverted to spending on other goods and services. And partially offsetting this reduced consumer demand will be increased business investment spending, induced by the HST shift itself. However, the increased business spending will be spread over many years, so that it will not immediately offset any decline in consumer spending. Notable is the uncertainty over whether the HST will survive the upcoming referendum, which undoubtedly has caused many businesses to defer their plans to increase spending.

6. HST drives the economy underground

“In 2009, the Institute for Fiscal Studies produced a report that showed ‘leakage’ from VAT evasion in the UK of between \$20 billion - \$30 billion per year. When the HST is evaded the government loses twice—the HST is not charged, and the income not reported.”

As a form of value-added tax (VAT), the HST has a built-in mechanism for discouraging evasion on inter-firm sales; this works through the need to report the tax paid on purchases in order to claim the offsetting input tax credit. Even unreported inter-firm cash sales do not affect whether the government gets its revenue so long as tax is collected from the final consumer. Therefore, the weak link in the HST compliance is at the final stage of sale to the consumer; yet, this is the same point at which the old PST was also vulnerable to evasion. For a business to enter the underground economy, it must

¹³ Timely monthly statistics are available for BC only for the narrower category of “retail sales” (which do not include all consumer expenditures), but they show an average of \$4,827 million per month for January-June 2010 and a nearly identical \$4,821 million per month for July-December 2011. Source: Statistics Canada vector number v52367245.

forego its ability to claim input tax credits on its purchases under the HST. Underground activity is dominated by small service suppliers such as home repair, maintenance, and renovation services; even these underground suppliers must pay HST on the materials and supplies that they purchase for use in their covert supply. Moreover, any increased underground activity with the HST results from its extension to additional small service suppliers such as house painters, gardeners, and hairdressers—and not to the shift from a PST format to a VAT-type HST format. Had BC’s PST coverage been extended to these services, the same inducement toward evasion would have arisen. Yet, the “Truth” report has not provided any evidence supporting its claim of large increases of underground activity caused by the BC HST.¹⁴ Most people (both sellers and customers) who would evade the HST at 12 percent were already evading the GST at 5 percent; individuals tend to be either compliant or non-compliant and are little affected by the rate of tax.

5. HST kills jobs and hurts the economy

“The provinces with the highest unemployment—Newfoundland 12.4%, Nova Scotia 9.5%, New Brunswick 9.1%, BC 8.2%, and Ontario 8.1%—all have the HST. The three provinces with the lowest unemployment—Manitoba 5%, Saskatchewan 5.4% and Alberta 5.9% do not have HST.”¹⁵

The “Truth” report’s recitation of figures for the unemployment rates in various provinces with and without an HST proves nothing, as anyone familiar with the long-run patterns of regional labour markets in Canada would know. The three larger Atlantic provinces, all having adopted an HST in the latter 1990s, have almost always had the nation’s highest unemployment rates, both before their HST and in the periods since then. Also, the report did not mention Prince Edward Island, which does not have an HST, yet also has traditionally high unemployment (11.2 percent as of March 2011, which is higher than two of the HST Atlantic provinces). Another omitted point is that the other three Western provinces besides BC have been experiencing exceptional world demand and prices for their main commodities of crude oil, agricultural products, and potash.

¹⁴ The report quotes a representative of a Vancouver homebuilders’ association, “Suffice it to say, HST will fuel an already burgeoning underground economy,” but that was in September 2009, nearly a year before the HST came into force in BC, and no tangible evidence was provided.

¹⁵ The rest of the report’s statement is “If the HST really stimulated growth—then *corporate income taxes would increase* to offset lost sales so consumers would not have to pay more HST.” I address the fiscal issues in my comments on the “Truth” report’s point 3 below.

BC's major export commodities of lumber, forest products, and natural gas, in contrast, have continued to suffer depressed pricing. Thus, it is remarkable that BC has seen only a very small increase in its unemployment rate (seasonally adjusted) in the period since harmonizing its sales tax. In June 2010, the month before the HST came into effect, BC's rate was 7.8 percent, and in the most recent figures for March 2011 it was 8.1 percent.¹⁶ That 0.3 percentage point difference is exactly equal to the "standard error" reported by Statistics Canada for the measure of BC's unemployment rate. The difference would have to be at least twice that large, at two standard errors or more than 0.6 percentage points, to have even a modest degree of confidence that BC's unemployment rate is actually any higher now than prior to implementing the HST.

4. HST is unnecessarily complicated

"Under the HST, business accountants must track millions and millions of transactions and remittances, and the thousands of quarterly reports to government. But none of that is necessary. Simply exempting businesses from sales taxes would be a far simpler system than the cumbersome HST."

Abolishing the PST and merging BC's sales tax with the federal GST in the HST has cut the compliance burdens on business in half. Rather than having to understand and comply with two very different sets of laws, regulations, bureaucracies, and remittances, BC businesses now face just a single tax. The savings in compliance costs for BC businesses are \$150 million per year, which improves their competitiveness and yields lower or more slowly increasing consumer prices. All businesses producing taxable goods and services under the HST already had to deal with interpreting and complying with the federal GST prior to BC's tax harmonization. Moreover, while BC expanded its tax coverage to a few goods and many new services, all of those items had already been taxable under the GST so that the businesses were already incurring GST compliance burdens. Since HST compliance burdens are very close to those of the GST, businesses enjoy a pure savings from no longer having to deal with the BC PST.¹⁷

¹⁶ Statistics Canada, *Labour Force Information*, Catalogue no. 71-001-X, various issues.

¹⁷ On this topic, the "Truth" report invokes another red herring in citing the complexity of the formulas for revenue sharing under the BC-federal HST agreement. "And they call that simpler? At least under the PST, we knew how to multiply 7% by whatever goods it applied to" (p. 10). This objection confuses compliance complexity for businesses and consumers, who have no need

A most astonishing assertion in the “Truth” report is that “simply exempting [all businesses] from sales taxes [under the PST] would be a far simpler and less costly system than the cumbersome and complicated HST” (p. 10). A major defect of this proposal is the difficulty of restricting use of the exemption to purchases for business inputs rather than consumer use. For example, a carpenter bearing an exemption certificate at the building supply store could purchase tax-free tools and materials for either work use or use in his or her own home or hobbies; a business person bearing an exemption certificate could book into a hotel or partake of a restaurant meal tax-free whether on business or personal travel; an owner of a clothing manufacturer could purchase sewing machines and many other kinds of items tax-free regardless of their business or personal use. This inherent inability of exemption certificates to distinguish between business and personal usage explains the aversion of jurisdictions with PSTs (including pre-HST BC) to extending their provision very far. In contrast to the point-of-sale operation of PST exemption certificates, the input tax credits and business-level accounting of the HST permits much fuller removal of tax on business inputs.

An equally astounding aspect of the Fight HST suggestion that we return to the PST but exempt all business purchases of inputs from tax is that it would raise precisely the same fiscal issues as with BC’s shift to an HST. Let us assume that these exemptions would apply to the same extent as the business inputs now relieved from tax under the HST. This approach would cost the BC treasury the same \$1.9 billion as the revenue loss from business-level taxes associated with the shift from PST to HST.¹⁸ Whoops, Fight HST advocates would now be confronted by exactly the same revenue issue faced by the BC government in harmonizing with the GST: how to recover the \$1.9 billion of lost annual revenues. Several choices would be available: i) raise the PST rate to more than 11 percent while keeping its original taxable base and exemptions of many services;¹⁹ ii)

to understand these formulas, with a technical calculation undertaken by civil servants (analogous to complex calculations undertaken for other programs such as Equalization). Such HST revenue sharing formulas have operated smoothly for the harmonized Atlantic provinces since 1997.

¹⁸ Note that about \$2.5 billion of PST was borne by businesses, and the shift to HST removed \$1.9 billion annually or about 75 percent of the total burden; the remaining \$600 million still borne by BC businesses under the HST is explained by technical issues, by HST “tax-exempt” items, and by the constraint on input tax credit claims for some purchases by large business.

¹⁹ Take the total annual PST revenues as \$5.0 billion, of which \$1.9 billion is removed through extended business exemptions, for \$3.1 billion net; the requisite rate is then $7 \times (1 + 1.9/3.1) =$

keep the PST rate at 7 percent, but extend its coverage to all of the goods and services that were newly covered by BC under its HST; iii) recoup the \$1.9 billion by raising other taxes on British Columbians; or iv) curtail public services to the tune of \$1.9 billion. None of these alternatives is politically palatable, but Fight HST proponents would be forced to choose if they pursued their PST-with-business-exemptions approach.

3. HST is revenue neutral to the BC government

“One of the biggest myths surrounding the HST is that it will help to pay for government services such as health care and education. But the HST is really a \$2 billion tax transfer from the corporate sector to the consumer with no new revenues going to government.”

The source of the report’s asserted “myth” is not specified; in its 2011 budget documents, the BC government stated clearly its calculations that the HST shift along with companion tax and compensatory measures would be revenue-neutral in the initial year.²⁰ The “Truth” report errs in citing a basic fact about the PST, stating that “Under the PST, the government collected approximately \$4 billion per year” (p. 11), whereas the correct figure approached \$5 billion for the last full year of the PST. Wild assertions about the fiscal implications of the switch to HST clutter the report, such as its estimate that returning to the PST would “save ourselves \$10 billion in higher taxes!” over five years and that “the average individual BC taxpayer over the course of their adult life will pay \$30,000 - \$40,000 more in taxes than under the PST” (p. 12). Ominous fiscal consequences are predicted for BC if the HST is retained, including the need to raise taxes, cut public spending, and/or incur more public debt. All of the report’s analysis ignores the fact that most of the taxes paid by business under the PST were actually borne by consumers in higher prices and the evidence that high pass-through of the business tax savings offsets the majority of the additional taxes paid by consumers under the HST.

Contrary to the “Truth” report’s dire fiscal forecasts, the HST should actually put BC public finances on a sounder course for the future. The HST’s broader coverage of services makes for more balanced and neutral tax treatment of the full range of consumer

11.3 percent. If the exemptions were extended to the full \$2.5 billion of former PST burden on businesses, the requisite revenue-neutral rate for BC PST would rise to nearly 14 percent.

²⁰ See B.C. Ministry of Finance, *Budget and Fiscal Plan 2010/11 – 2012-13* (Victoria, BC: March 2), p. 101.

spending than under the PST. Given that services now account for more than 60 percent of BC consumer expenditures, and services have been steadily rising in their share of such spending, the provincial revenue base with the HST should slowly grow over future years. Moreover, the shift from PST to HST itself will promote provincial economic growth, which will generate additional revenues in future years from the HST, personal, corporate, and property taxes—all at unchanged rates of tax. In short, BC's sales tax harmonization provides the basis for stronger, more stable public finances to cover the population's growing needs for publicly provided health care, social services, education, transit, and other public facilities. It is bewildering that the province's main opposition party, which supports better public provision, should oppose the HST. They often cite with favour the Northern European social democratic countries' extensive public services, but fail to recognize that those services rely heavily on value-added taxes like the HST for their finance.

2. HST is a loss of provincial sovereignty

“The HST gives control of BC's sales tax authority to the Federal Government. It turns BC into the equivalent of a giant municipality, awaiting transfers of our own money back from Ottawa.”

British Columbia has long had tax collection agreements under which the federal government fully administers and collects BC personal and corporate income taxes on behalf of the province and remits the funds to the provincial treasury. No one has complained about the loss of provincial sovereignty from these arrangements, despite the fact that BC is constrained to many aspects of the federal definition of taxable income. Joint collection of federal and provincial taxes by the Canada Revenue Agency creates major savings in tax administration for the BC government, major savings in compliance for taxpayers, and improved compliance and enforcement. Few BC residents would be pleased with the prospect of having to file two separate income tax returns each year—one to the feds and one to the province, each with differing definitions of what is taxable, what is deductible, and myriad other rules and procedures. That situation is faced by taxpayers in Quebec and most US states that have an income tax operated separately at the sub-national level. Restoring the PST would again confront BC businesses with exactly this situation of needing to understand and comply with two separate sales taxes.

Does BC's participation in a harmonized sales tax with the federal government compromise provincial sovereignty to a serious degree? Under the HST, the province has designated some items as non-taxable despite the fact that they remain taxable under the federal portion of the HST. Some of these BC HST non-taxable items were previously tax-exempt under the PST, such as books, child-sized clothing and footwear, gasoline, child car seats, and feminine hygiene products. A major item that BC chose to make non-taxable despite its taxability for GST is residential fuels and energy. Another notable difference from the federal GST is BC's far more generous HST rebate for new housing. In terms of changing its rate within the HST, the province is more constrained in that the agreement with the feds requires a notice period that could delay the tax rate change. However, BC has changed its PST rate only 10 times since initiating the tax in 1948, or less than once every six years on average. This constraint is hardly an abandonment of provincial sovereignty, and if the province decides either this year or at any future time to revoke its HST, this option is always open. One of the more bizarre assertions in the "Truth" report is that "the BC Liberals ... have set the stage for a future provincial government to reinstitute a PST on top of the HST at some point!" (p. 13).

1. HST threatens democracy

"The BC Liberals want us to believe that repealing the HST will be too costly ... and that's probably true—for them. A defeat of the HST in the Referendum will change the way governments operate in BC forever. Never again will any government in BC be able to lie, obfuscate or deliberately cheat people out of their hard earned tax dollars."

The "Truth" report's assertion that a BC referendum outcome favouring the PST over the HST "will change the way governments operate in BC forever" is pure hyperbole. It is not such a rare event for governments to take policy actions following an election that they had disavowed prior to the election or during the campaign.²¹ No matter what the outcome of BC's HST referendum, only the naïve would forecast a departure from politics as usual and never again any unanticipated major policy change, regardless of what party leads the government. The next provincial election is the

²¹ One striking example is Dalton McGuinty's publicly signed pledge to "[n]ot raise taxes or implement any new taxes without explicit consent of Ontario voters" just one month before his election in 2003 as Ontario premier, followed in his first budget by a new multi-billion dollar tax. For his pledge, see http://www.taxpayer.com/sites/default/files/Liberal_Pledge-2003-09-11.pdf

appropriate time for citizens to chasten the incumbent government, if that is their inclination. The HST referendum, in contrast, is the right time for citizens to reflect thoughtfully on the course of tax policy that will best serve their economic futures.

The cost of repealing the HST for British Columbians would be not just the \$1.6 billion to be repaid to the federal government (equivalent to raising the BC sales tax rate to 9 percent for one year). The province would also need to reinstitute its own sales tax collection bureaucracy at an annual cost of \$30 million, and BC businesses would incur significant transition costs plus ongoing \$150 million costs of tax compliance. These costs would mostly be passed along to BC residents in their capacity as taxpayers and consumers. But much larger than these costs would be the loss of HST-induced growth of investment, employment, and earnings resulting from restoration of the PST. To shift from a value-added tax like the HST to an antiquated, economically damaging PST would be unprecedented anywhere in the world.

The “Truth” report concludes that “The PST may not be the best tax, but it is *far, far superior* to the HST” (p. 16). My evidence and analysis reaches precisely the opposite conclusion: sticking with the HST is a far, far superior course for BC than returning to the PST and GST. That the “Truth” report cannot identify a single factual or economic point in support of returning to the PST and needs to rely on numerous misleading arguments speaks volumes about the superiority of the HST. The public’s disenchantment with the HST stems mainly from exaggerated notions of the impact on their pocketbooks. Most people fail to recognize both the hidden nature of nearly half of the old PST and the full pass-through to consumers of business tax savings on their in-province sales under the HST. Taxes that BC consumers were paying in a hidden way with the PST they are now paying in a visible way with the HST. Moreover, the shift to HST along with compensatory measures has been advantageous to the poor and moderate income households, as shown in my numerical examples. Even at middle incomes, the net burdens from HST are very modest—just \$3 per week for a \$50,000 single earner. Should we forego large long-run gains for the prosperity of our province and workers in return for a small net savings in our pockets today? Voting to restore the PST and GST will have major adverse consequences for British Columbians. That’s the real truth.